

EXHIBIT 2

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TO: Distribution
FROM: Marian Wood *(Marian)*
SUBJECT: ALL NATURAL REVIEW

DATE: November 6, 1995**BACKGROUND**

The concept of "all natural" has been gaining momentum for a number of years in several product categories. For instance, the all natural platform has been used for ice cream (Dolly Madison), tea (Lipton) and make-up (The Body Shop).

Further, all natural cigarette products, such as those manufactured by Nat Sherman, have also been available for a number of years. However, not until recently have all natural cigarette products been gaining public attention and popularity. Specifically, it appears that following the cigarette ingredient debate in 1994, the viability of this platform has gained strength among consumers. Further, recently there have been a number of All Natural product introductions and each of these brands are available in a variety of packings.

There is no clear definition for the term "all natural" as used by the different cigarette manufacturers. For instance, some may use "all natural" to refer to tobacco that is additive free. Others use the term to signify that their tobacco does not use fillers like expanded or reconstituted tobacco.

The size of the all natural niche is difficult to determine since many of these products are distributed through the mail and are sold in untraditional outlets. However, based on SPACE information the All Natural category share is quite small (<0.2%). Still, it is possible that the All Natural category can provide an opportunity for a PM introduction.

The following describes available information on the recent all natural cigarette introductions. This information was obtained through both primary sources (qualitative and quantitative research) and secondary sources including newspaper and magazine articles, company literature and PM Stars Store Data. **(Attachment 1)**

NATURAL AMERICAN SPIRIT**Product**

Natural American Spirit is the brand that is primarily responsible for the recent focus on all natural cigarette products and is the one about which we know the most. Further, in the All Natural category, this product seems to be the most popular brand among smokers, particularly young adults of varying psychographic profiles. These smokers include Progressive young adults (ie. previous Camel Lights smokers), Generation X (naturalists) and alternative lifestyle smokers.

American Spirit is manufactured by the Santa Fe Natural Tobacco Company in New Mexico. The product, sold at a super premium price, has been on the market since 1985 and is available in four packings:

- Unfiltered KS Soft Pack
- Filtered KS Soft Pack
- Filtered KS Mild Soft Pack (Since June 1995)
- Menthol KS Hard Box

(Attachment 2)

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American Spirit products contain 25% more tobacco than other king size products. Further, both the unfiltered and filtered versions are full flavored products and are have a higher tar content than Marlboro Red.

	<u>Tar</u>	<u>Nicotine</u>
Filtered	18.4mg	1.87 mg
Unfiltered	26.1 mg	2.55 mg
Marlboro Red	17.0 mg	1.2 mg

Despite the Milds' June introduction, a Customer Service Representative for the Santa Fe Natural Tobacco company said that T&N measures for Milds were still unavailable.

In addition to the four cigarette packings, American Spirit is also available as pouch tobacco.

Distribution

Santa Fe Natural Tobacco Company distributes American Spirit products direct to customers through the mail. Personal orders account for about 55% of sales and retail orders account for about 45% of sales. At retail, the product is available in specialty stores like natural food stores, health food stores, gourmet food and wine shops and herb stores.

The company managed to increase its retail business by asking current customers to recommend potential customers. Further, the company encourages personal order customers to urge stores in their area (no chains) to stock American Spirit. Currently the product shows the greatest presence in stores in Region 5, followed by Region 1. Actual measures of distribution and share are difficult to obtain since the company uses untraditional distribution channels.

(Attachment 3 & 4)

Product Positioning

The concept for Natural American Spirit is based on the traditional American Indian usage of tobacco in its natural state. Originally, the tobacco for the product was grown on Indian lands in New Mexico but the Department of Agriculture stopped that practice.

However, the company claims to still maintain ties with American Indians by contributing money and tobacco to a variety of American Indian causes. Further, they claim that they want to commit resources and to enlist consumer support in the fight to let American Indians grow tobacco for commercial use.

The product is positioned as an all natural, chemical free cigarette. The packaging itself claims "100% Additive Free Natural Tobaccos" and "Guaranteed 100% additive-free Virginia tobacco and nothing else." Further, the American Indian imagery on the pack serves as a reminder of tobacco's original use in its natural state. In addition, the retail outlets in which the product is available, like natural food stores and health stores, reinforces this all natural image.

Marketing Strategy

The company uses a three pronged marketing strategy to appeal to consumers:

- The marketing appeals to consumers' intelligence. For instance, the company sends mail-order customers informative company literature that addresses the "all natural" issue and seeks to imply a sense of full disclosure.

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- The imagery creates an emotional bond. For example, the American Indian graphics bonds people with America's origins. Further, this imagery is reinforced with smoking accessories and logo printed incentives.
- The product has an aura of exclusivity. Specifically, the brand is advertised in select books like the Utne Reader and Mother Earth News. Further, it's sold at a super premium price in untraditional outlets which sets it apart from other brands.

(Attachments 5 & 6)

The marketing strategy creates both intellectual and emotional consumer benefits. For instance, most apparent is the perceived health benefit. Also, the imagery reassures smokers about their decision to smoke, apparently appealing to "guilty" smokers. Finally, the imagery creates a tie to American Indians who to some, are an oppressed minority.

STAR TOBACCO COMPANY'S ALL NATURAL TOBACCO BRANDS

Star Tobacco Company, based in St. Petersburg, Virginia, was formed in 1990 by two former B&W employees. Further, a former PM employee has been identified as the company's Marketing V.P.

Over the past couple of years, Star Tobacco Co. has introduced a number of all natural products. The products, all of which are sold at discount prices, include Gunsmoke, Vegas, Main Street, Sport and Free Spirit. The range of products suggest that the company is trying to reach a variety of consumers.

Attachments 7 & 8

Gunsmoke

Gunsmoke was the first all natural product Star Tobacco Co. introduced. The product line-up includes king size, 100's, full flavor, lights, hard box, soft pack and menthol packings and is distributed by Budd Mayer Co.

Initially, the product was test marketed in the west coast. After showing strong test performance in a national grocery store chain believed to be Safeway, (10th place out of 157 brands offered), the product was rolled out nationally in October 1994.

Gunsmoke initially attempted to have a western feel by borrowing from Marlboro's image. For instance, the original packs displayed a cowboy or cowgirl and stated "Western Blend". Also, the western imagery was further reinforced by special appearances by the Gunsmoke man and woman and through a merchandising effort using the Gunsmoke vans.

Based on the original brand image, it appears Gunsmoke was attempting to attract Marlboro men and women. However, the pack has since been redesigned because of its impermissible association with Marlboro's image.

Attachment 9

The all natural aspect of the product is highlighted on the pack and featured in the news release. For instance, the pack claims "100% Natural Tobaccos". Also, the news release says, "Gunsmoke cigarettes feature high quality, 100% natural tobaccos with no fillers or reconstituted tobacco."

Vegas

Vegas was also one of the earlier all natural tobacco introductions by Star Tobacco Company. Then, in early April 1995, a redesigned version of this product was shipped to distributors nation wide. Vegas' line-up currently has 12 packings, which include:

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Full Flavor King Size (Soft & Box)
Lights King Size (Soft & Box)
Full Flavor 100's (Soft & Box)
Lights 100's (Soft & Box)

Menthol 100's
Menthol Lights 100's
Menthol Box King Size
Ultra Lights King Size

The current Vegas pack features a roulette wheel and, like Gunsmoke, says "100% Natural Tobaccos". The red color cues and association with Las Vegas suggest that this product is geared towards young adult men.

Valentine

Valentine was introduced in fourth quarter 1994 and is being distributed with Gunsmoke through food brokers. The product name, white pack and "Lips" pack graphic are designed to appeal to women.

Free Spirit

In 1st quarter 1995, Star Tobacco Company introduced Free Spirit. This product is available in full flavor and lights soft pack. However, the Lights packing is actually a full flavored product by industry standards (17 mg tar, 1.8 mg nicotine).

Kretek Distributors Inc. in Moorpark, CA mails product direct to retailers. Like other Star Tobacco products, Free Spirit is sold at a discount price. In addition, the product is also supported with incentives like lighters, t-shirts and sweatshirts that feature the Free Spirit Logo.

The product name, Free Spirit, associates the brand with the more successful Natural American Spirit. In addition, similar to American Spirit, Free Spirit packs claim "100% Pure & Natural Virginia Tobaccos, No Preservatives or Chemicals Added."

USA Gold

USA Gold is available in eleven packings and was made available to distributors in Kansas in 1st quarter 1995.

Main Street

Main Street is another all natural Star Tobacco Co. introduction. No other information is currently available on this product.

Sport

The most recent all natural introduction by Star Tobacco Co. is Sport. This product, available in eleven styles which include full flavor, lights, menthol, box, soft, kings and 100's, was introduced in July 1995. The pack features a sail boat and, like the other Star tobacco products, claims "100% Natural Tobaccos".

Attachment 10

PURE

Tobacco Alternative, Inc., based in Buffalo, New York, manufactures and distributes PURE cigarettes. This company employs twenty eight people, including fourteen part-timers, and also distributes the following nicotine free/tobacco free herbal cigarettes:

Herbal Gold
Magic
and a custom blend of:
Jasmine, Ginseng, Red Clover, Khatmi and Yerba Santa

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PURE is a recent all natural introduction, reaching the market in 2nd quarter 1995. The product is offered in three soft pack, king size packings (full flavor, lights and menthol) and is sold at a discount price to wholesalers in eastern Kentucky (\$6.50/carton). All product is cork-tipped.

Attachment 11

Similar to other all natural introductions, PURE was developed in response to the cigarette ingredient debate in 1994. Again, the product claims to be 100% natural tobacco of the highest quality with water as the only ingredient added to the blend. Further, similar to Natural American Spirit, PURE's marketing platform hearkens back to tobacco's original use by Native Americans. Specifically, their introductory flyer states,

Native Americans smoked all natural tobacco without the ills that are associated with smoking today. Could it be that the chemicals and additives cause more health problems than natural tobacco smoke itself?

In addition, attached to their sales brochure is a list of additives that can be included in mass-produced popular brands, but which they claim not to include.

Conclusions & Recommendations

The number of recent All Natural introductions suggests that this category may show growth in the future. However, at this time, it appears that American Spirit is the only all natural product that has succeeded in developing a viable image for itself. The other all natural brands seem to incorporate elements of the American Spirit marketing strategy to appeal to consumers rather than developing their own identity.

Since imagery in the all natural niche focuses on the American Spirit platform, there appears to be an opportunity for PM to develop an all natural product that has a distinct image that can appeal to consumers with an approach that is different from American Spirit's strategy.

In the future, all natural introductions will continue to be monitored and pertinent information will be communicated.

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